Atlantic Pilotage Authority

Administration de Pilotage de l'Atlantique

Atlantic Pilotage Authority

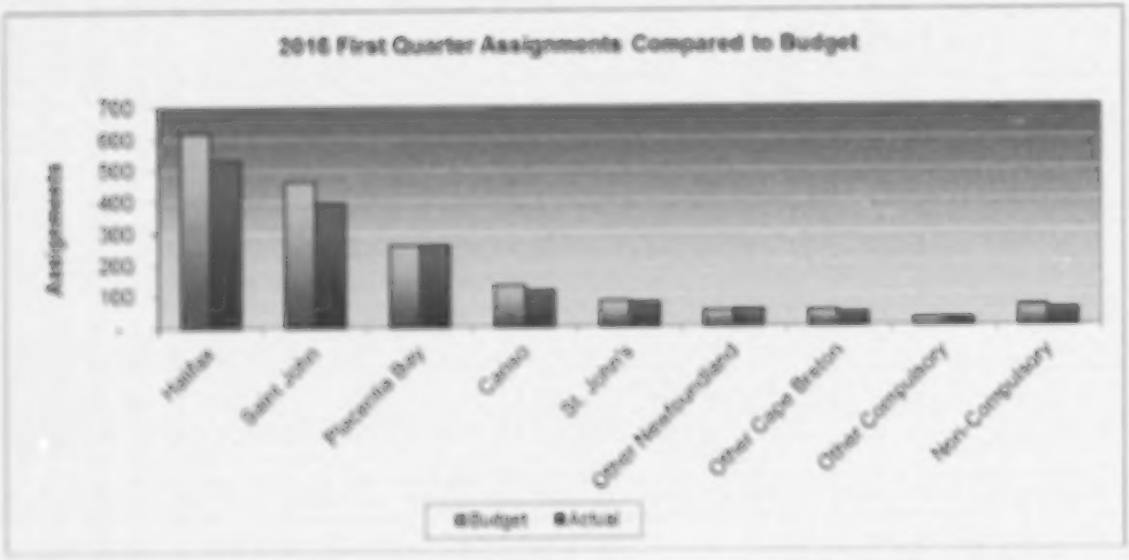
First Quarter 2016

Management's Discussion and Analysis

May 30, 2016

Traffic Review

Pilotage Area	Actual Traffic through 1st Qtr 2015	Budget Traffic through 1st Qtr 2016	Actual Traffic through 1st Qtr 2016	Variance from 2015	Percentage Variance from 2015	Variance from Budget 2016	Percentage Variance from Budget 2016
Halifax	576	617	531	-45	-8%	-86	-14%
Saint John	470	462	394	-76	-16%	-68	-15%
Placentia Bay	259	259	257	-2	-1%	-2	-1%
Canso	154	131	113	-41	-27%	-18	-14%
St. John's	143	83	76	-67	-47%	-7	-8%
Other Newfoundland	53	51	53	0	0%	2	4%
Other Cape Breton	52	52	43	-9	-17%	-9	-17%
Other Compulsory	22	22	23	1	5%	1	5%
Non-Compulsory	62	63	55	-7	-11%	-8	-13%
Total	1,791	1,740	1,545	-246	-14%	-195	-11%



The following discussion regarding the amount of activity in individual ports is referring to pilotage assignments only, and not the level of cargo or vessel traffic experienced by a port. There are several factors that may result in a difference between the activity reported by the Authority and that reported by another body such as a port authority. These factors include ships not subject to compulsory pilotage, ships utilizing mariners who have pilotage certificates, and the amount of cargo carried on a ship. The Authority reports on pilotage assignments performed by its pilots, but does not track the amount of cargo being carried on a vessel.

Overall, pilotage assignment traffic levels for the Authority are below the first quarter of 2015 and the budget for 2016. The Authority has four major compulsory ports (Halifax, NS; Strait of Canso, NS; Placentia Bay, NL; and Saint John, NB) that contribute approximately 75% of its pilotage assignments each year. All four major ports have had fewer assignments

than in 2015. This reduction has left these areas below budget through the first quarter. Overall, the Authority is 11% under budget in activity and 4% under budget for revenues. The reason for the discrepancy between assignments and revenue is a result of the decline in activity being due to the loss of smaller vessel assignments, which have lower average revenue, and having other remaining vessel traffic increase in size over what was budgeted.

The decline in traffic in Halifax, NS is largely due to a 43% (or 60 assignment) reduction in tanker assignments from the previous year. This is due primarily to a decrease in moveages within the harbor of tanker vessels due to masters having pilotage certificates. General cargo assignments have also fallen 22% (or 46 assignments) due to certificated masters. Thus far in 2016 container traffic has increased 28% (or 59 assignments) with two additional weekly callers. Total pilotage activity in the port is 14% under budget with revenues under budget by 7% through March 2016.

The traffic in Placentia Bay, NL is generated primarily from two major oil industry customers. There is the Come-by-Chance Oil Refinery and the transshipment terminal at Whiffen Head. Traffic at both facilities has been very close to budget and to the previous year, but the average size of vessels at both facilities has increased. Assignments in the area are 1% below 2015 levels and the 2016 budget while revenues are 5% over in each of these categories.

In Saint John, NB, the Authority has had 15% fewer pilotage assignments in the first quarter of 2016 compared to 2015. Pilotage assignments on tankers have decreased by 23% (76 assignments) and decreased by 66% (or 27 assignments) on general cargo vessels. There continues to be growth with container vessels in the port as they are up 38% (or 16 assignments). Smaller vessels, like tug and barge traffic are also up over 2015 by 24 assignments. Revenues in the port are 14% under budget with the decreased pilotage activity.

In Canso, NS, first quarter tanker traffic has decreased by 8% (or 6 assignments) from 2015 levels due to fewer assignments on a small bunker tanker travelling between Canso to Halifax (7 fewer assignments in 2016 than in 2015). There has been an increase in larger tankers for the area that has offset a portion of the revenue lost. Dry cargo traffic has declined in the area by 43% (or 33 assignments) from 2015 with a reduction in coal transshipment activity. The combination of these factors has left the area 14% under budget in activity, but only 1% under budget on revenues through March 2016.

COMPARATIVE REVIEW FINANCIAL AND STATISTICAL DATA As at March 31		
	2016	2015
FINANCIAL (000'S)		
Total Revenue	$ 4,899	$ 5,091
Operating Expenses		
Salaries, Fees and Benefits	3,377	3,528
Pilot Boats	1,388	1,442
Other	588	584
Total Operating Expenses	5,353	5,554
Loss/Gain	$ (454)	$ (463)
STATISTICAL		
Pilotage Assignments	1,545	1,791
Shipping Incidents	2	0
% of incident free assignments	99.87%	100.00%
Customer Complaints Filed	2	6
% of complaint free assignments	99.87%	99.66%

The revenue for the Authority has decreased in spite of a tariff increase that came into effect in March of 2016. Overall, traffic has decreased by 14% from 2015 levels through March, with revenues decreasing by 4%.

Salaries, fees, and benefits for the first quarter of 2016 have decreased from the same period of 2015 as overtime costs have been reduced. This reduction is partly because of a reduction in overall assignments, and partly because pilots hired recently have increased in licence, providing an increase in productivity. Pilot boat costs have decreased due to savings on fuel with lower prices on diesel. Other expenses are very similar in total to those of the previous year.

The Authority has been investing in additional pilots to prepare for pending retirements and provide the desired level of customer service. The Authority was negatively affected by a shift to smaller vessels in 2015 in several ports. This trend has rebounded thus far in 2016

and the average vessel size has increased for the Authority.

Halifax has had the increase in large container vessels that began calling in September of 2015. The number of masters who have certificates to pilot their own vessels in the area have increased and resulted in the loss of a number of smaller revenue assignments for the Authority. Placentia Bay is a large revenue generator for the Authority and an area where significant investment has been made in pilot boats and in increasing the number of pilots. The effects of planned maintenance shutdowns are not expected to be as severe as those experienced in 2015 and pilotage revenues in the area are expected to rebound in 2016. For Saint John, it was announced early in the year that PotashCorp would be suspending its potash operation in the area indefinitely. The Authority had been anticipating increased production from the new potash mine. The smaller, lower revenue vessels that increased traffic levels in Canso in 2015 have stopped transiting the area. Larger tankers have offset this loss thus far in 2016. A coal transshipment operation in the area has decreased operations due to a reduced global demand for the commodity, and the low world market prices of coal.

Early in 2016 it was announced that Little Narrows Gypsum may not do any shipping this year which would have a large effect on the pilotage area of Bras d'Or, NS. The traffic in St. John's, NL has declined as expected with a number of the supply ship masters having passed certificate examinations and having received pilotage certificates allowing them to pilot their own vessels.

The Authority had a loss in the first quarter of $453 thousand. A loss of $583 thousand was budgeted for the quarter. Expense reductions have offset the lost revenue thus far in the year.

CUSTOMER COMPLAINTS AND LEVEL OF SERVICE

The Authority developed a structured methodology for handling complaints several years ago in response to the Ministerial Review of Outstanding Pilotage Issues. The mechanism is designed to be as user friendly as possible, and the goal of the Authority is to ensure that timely feedback is provided to the complainant. The most common reason for a complaint to be submitted is due to a delay in an assignment. In some cases, the delay is caused by factors beyond the control of the Authority, such as weather or delays caused by the non-availability of port services such as tugs.

The Authority received a total of 2 complaints out of a total of 1,545 assignments during the first quarter of 2016. The remaining 99.87% of assignments were performed without a complaint from the customer. For the same period of 2015, there were 6 complaints received out of 1,791 assignments, meaning 99.66% of the assignments had been performed without complaint. All complaints received are included in the above totals, including those submitted that involved delays not caused by the Authority.

Through March 2016 the Authority has had two minor shipping incidents. There were no incidents reported at this point in 2015.

RISK ANALYSIS

The major financial risk faced by the Authority is the variability of traffic in major ports. The Authority does not control or influence the activity in each port. Variations in the number of ships, or the average ship size, from the budget may result in a significant positive or negative result. The variation in ship size was a significant contributor to a poor financial result in 2015. Thus far in 2016, the average vessel size has increased, but the total number of assignments has declined.

Maintenance at facilities related to offshore oil extraction or oil refining can also have a significant impact on the Authority. Maintenance in Placentia Bay, NL and Saint John, NB was detrimental to the Authority in the previous year. Any maintenance planned for 2016 is not expected to be as prolonged. As mentioned previously, announcements regarding the potash mine in Saint John, and the gypsum mine in Bras d'Or, NS, will reduce expected revenues in those areas. Ship masters who have the required experience, and have passed a certificate examination, have the ability to pilot their own vessels in their designated areas. This has also caused a decline in pilotage assignments for the Authority and has had a great effect on the port of St. John's NL, while having a lesser effect on the port of Halifax, NS.

The cost structures in these ports are not easily adjusted. Due to the specialized nature and training required to be a marine pilot, reducing the work force in a port is not feasible to address short term declines in activity. It is unknown at this point for how long the mining operations will be suspended in each area discussed above. Certificates pose an additional challenge as these specific masters may leave at any point or be unavailable to their employer. This would result in a spike in traffic for which the area will need trained pilots. A reduction in the number of pilots can have significant consequences on the shipping industry with the potential for delays during peak periods, or if the port experiences an unexpected surge in activity. The Authority has also made a significant investment in new vessels that have to be supported through tariff revenue in the ports of Placentia Bay, Halifax, and Saint John. Variations in expected traffic in these areas pose an additional risk due to the fixed nature of these costs.

One major financial risk faced by the Authority has been mitigated by prior action. The cost of fuel, which has a significant impact on the cost of operating pilot boats, has been offset by a fuel recovery charge applied to assignments in Halifax, Saint John, Placentia Bay and Canso.

The Authority has had two consecutive years with significant losses. The loss in 2014 was due primarily to costs incurred to expand its pilot numbers in an attempt to improve service levels and prepare for retirements. In 2015, the Authority's revenues were below budget due to maintenance issues that affected tanker assignments and an overall decrease in average vessel size. Included in the 2016 tariff is a surcharge that is meant to recover these losses over a three-year period and includes an agreement with industry to review it annually to determine its continued necessity and its effectiveness.

First Quarter 2016

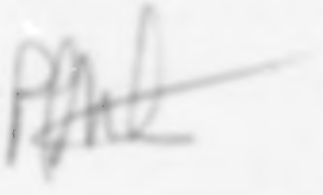
Interim Unaudited

Condensed Financial Statements and Notes

Management's Responsibility for Financial Reporting

Management is responsible for the preparation and fair presentation of these quarterly financial statements in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations, and for such internal controls as management determines is necessary to enable the preparation of quarterly financial statements that are free from material misstatement. Management is also responsible for ensuring all other information in this quarterly financial report is consistent, where appropriate, with the quarterly financial statements.

Based on our knowledge, these unaudited quarterly financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the corporation, as at the date of and for the periods presented in the quarterly financial statements.



Sean Griffiths
Chief Executive Officer

Peter MacArthur, CPA, CMA
Chief Financial Officer

Halifax, Canada
May 30, 2016

ATLANTIC PILOTAGE AUTHORITY

Statement of Financial Position

[illegible]

(in thousands of Canadian dollars)	March 31, 2016	December 31, 2015
Assets		
Current		
Cash	$ [illegible]	$ [illegible]
Trade receivables	[illegible]	[illegible]
Prepaid expenses	[illegible]	[illegible]
Other assets	[illegible]	[illegible]
	[illegible]	[illegible]
Non-current		
Intangible assets	[illegible]	[illegible]
Plant, boats and equipment	[illegible]	[illegible]
	[illegible]	[illegible]
	$ [illegible]	$ [illegible]
Liabilities		
Current		
Trade and other payables	$ [illegible]	$ [illegible]
Bank loans	[illegible]	[illegible]
Employee severance benefits	[illegible]	[illegible]
	[illegible]	[illegible]
Non-current		
Bank loans	[illegible]	[illegible]
Employee severance benefits	[illegible]	[illegible]
	[illegible]	[illegible]
	[illegible]	[illegible]
Equity		
Retained earnings	[illegible]	[illegible]
	[illegible]	[illegible]
	$ [illegible]	$ [illegible]

The accompanying notes are an integral part of these financial statements.

[illegible]
Statement of Comprehensive Income

[illegible]

	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
Revenues		
Mortgage charges	$ [illegible]	$ [illegible]
Other income	[illegible]	[illegible]
	[illegible]	[illegible]
Expenses		
Pilots' fees, salaries and benefits	[illegible]	[illegible]
Pilot hours, operating costs	[illegible]	[illegible]
Pilot hours assist' salaries and benefits	[illegible]	[illegible]
Staff salaries and benefits	[illegible]	[illegible]
Amortization and depreciation	[illegible]	[illegible]
Transportation and travel	[illegible]	[illegible]
Professional and special services	[illegible]	[illegible]
Utilities, materials and supplies	[illegible]	[illegible]
Training	[illegible]	[illegible]
Rentals	[illegible]	[illegible]
Communications	[illegible]	[illegible]
Outdoor costs	[illegible]	[illegible]
	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
Other comprehensive loss:		
Amounts not to be reclassified subsequently to net income		
Actuarial loss on employee accident benefits		
Other comprehensive loss		
Comprehensive loss	$ [illegible]	$ [illegible]

The accompanying notes are an integral part of these financial statements.

[illegible]

[illegible]

	Note	[illegible]	[illegible]
[illegible]		[illegible]	[illegible]
[illegible]		[illegible]	[illegible]
[illegible]		[illegible]	[illegible]
[illegible]		[illegible]	[illegible]
[illegible]		[illegible]	[illegible]
[illegible]		[illegible]	[illegible]

The accompanying notes are an integral part of these financial statements.

[illegible]

[illegible]

		[illegible]	
[illegible]			
[illegible]			
[illegible]	

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies are as follows:

(a) Financial instruments

Trade and other receivables and trade and other payables, classified as other financial liabilities, are measured at amortized cost using the effective interest method. Due to their short-term nature, the cost of these financial instruments approximates their fair value.

Bank loans are classified as other financial liabilities and are initially measured at fair value. After initial recognition, bank loans are measured at amortized cost using the effective interest method.

The Authority is not party to any derivative financial instruments or hedges.

(b) Intangible assets

The Authority's intangible assets are comprised of purchased software. When the software does not form an integral part of the machinery or computer hardware to which it relates, it is separately accounted as an intangible asset. Intangibles are carried at cost less accumulated amortization and impairment losses.

Any impairment is recognized in comprehensive income and is measured as the amount by which the carrying amount exceeds its recoverable amount.

(c) Pilot boats and equipment

Pilot boats and equipment are recorded at cost. The cost of pilot boats under construction includes design, project management, legal, material, direct labour, and interest on construction loans. Amounts included in pilot boats under construction are transferred to the appropriate pilot boat classifications upon completion, and depreciation commences.

Any impairment is measured as the amount by which the carrying amount exceeds its recoverable amount and is recognized as a loss for the year. Gains or losses arising on the disposal of pilot boats and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognized in profit or loss. Gains are recognized in other income, while losses are recognized as a loss for the year in pilot boats, operating costs, or utilities, materials and supplies depending on the assets that were disposed.

(d) Employee severance benefits

Employees are entitled to specified severance benefits as provided for under collective agreements or employment contracts, based on their years of service and final salary. The liability for these payments is estimated and recorded in the accounts as the benefits accrue to the employees.

The costs and the benefit obligation are actuarially determined using the projected unit credit method prorated on service that incorporates management's best estimate of the rate of employee turnover, retirement age, future salary and benefit levels, and other actuarial factors.

Actuarial gains and losses are recognized in the period in which they occur and are included in other comprehensive income.

(e) Pension plan

Substantially all of the employees of the Authority are covered by the Public Service Pension Plan (the "Plan"), a defined benefit plan established through legislation and sponsored by the Government of Canada. Contributions are required by both the employees and the Authority to cover current service cost. Pursuant to legislation currently in place, the Authority has no legal or constructive obligation to pay further contributions with respect to any past service or funding deficiencies of the Plan. Consequently, contributions are recognized as an expense in the year when employees have rendered service and represent the total pension obligation of the Authority.

(f) Revenue recognition

Revenues from pilotage charges are recognized when pilotage services are provided.

(g) Accounting standards issued but not yet effective

Accounting standards and amendments issued but not yet effective which are expected to be relevant to the Authority include:

In July 2014, the International Accounting Standards Board (IASB) issued the complete version of IFRS 9, "Financial Instruments", first issued in November 2009, which brings together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 introduces a principles-based approach to the classification of financial assets based on an entity's business model and the nature of the cash flows of the asset. The mandatory effective date of IFRS 9 is January 1, 2018.

In May 2014, the IASB issued IFRS 15, "Revenue from Contracts with Customers", which establishes principles for reporting about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The mandatory effective date of IFRS 15 is January 1, 2018.

In January 2016, the IASB issued IFRS 16, "Leases", which sets out the principles that both parties to a contract apply in order to provide relevant information about leases in a manner that faithfully represents those transactions. IFRS 16 requires all leases to be reported on the lessee's balance sheet. There are also changes in accounting over the life of the lease. In particular, the lessee will recognize a front-loaded pattern of expense for most leases, even when it pays constant annual rentals. Lessors' accounting treatment remains similar to current practice. They continue to classify leases as finance and operating leases. The mandatory effective date of IFRS 16 is January 1, 2019.

In January 2016, the IASB amended IAS 7, "Statement of Cash Flows", which requires an entity to present a statement of cash flows as an integral part of its primary financial statements. These narrow-scope amendments to IAS 7 requires entities to disclose information about changes in their financing liabilities as part of this statement. The mandatory effective date of the amendment is January 1, 2017.

The Authority has not early adopted any of these new standards and amendments and is currently assessing the impact that these standards will have on its financial statements. Therefore, the impact is not known at this time.

3. Use of Estimates and Judgments

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and revenue and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised.

Judgments made by management in the application of IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the current and following fiscal year are discussed as follows.

(a) Critical accounting estimates

Critical accounting estimates are estimates and assumptions made by management that may result in material adjustments to the carrying amount of assets and liabilities within the next year. Management has made the following critical accounting estimates or assumptions in preparation of these financial statements:

Amortization rates

Amortization of intangible assets is charged on a straight-line basis over the estimated useful lives of the assets. The useful lives used in the calculation of amortization for purchased software is 5 to 10 years.

Depreciation rates

Depreciation of pilot boats and equipment is calculated on a straight-line basis and is based on the estimated useful life of the assets as follows:

Pilot boat hulls and structures	10 to 25 years
Pilot boat equipment	5 to 10 years
Pilot boat generators	5 years
Pilot boat engines	5 to 10 years
Pilot boat inspections	4 to 5 years
Furniture and equipment	2 to 10 years
Leasehold improvements	10 years

Useful lives are based on management's estimates of the periods of service provided by the intangible assets and the pilot boats and equipment. The useful lives of these assets are reviewed annually for continued appropriateness. Changes to the useful life estimates would affect future amortization or depreciation expense and the future carrying value of the assets.

Employee severance benefits

The Authority engages an external actuary to assess the fair value of its employee severance benefits. The Authority assesses this obligation at December 31 each year.

(b) Critical accounting judgments

Critical accounting judgments are accounting policies that have been identified as being complex or involving subjective judgments or assessments.

Impairment test for non-financial assets

The non-financial assets with finite useful lives are required to be tested for impairment only when indication of impairment exists. Management is required to make a judgment with respect to the existence of impairment indicators at the end of each reporting period. Some indicators of impairment that management may consider

include changes in the current and expected future use of the asset, external valuations of the assets, and obsolescence or physical damage to the asset.